

**Department of Economic and Community Development**  
**For the Years Ended**  
**June 30, 2000, and June 30, 1999**

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STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

**John G. Morgan**  
Comptroller

November 15, 2001

The Honorable Don Sundquist, Governor  
and

Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable Tony Grande, Commissioner  
Department of Economic and Community Development  
10<sup>th</sup> Floor, W. R. Snodgrass Tennessee Tower  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Economic and Community Development for the years ended June 30, 2000, and June 30, 1999.

The review of management's controls and compliance with policies, procedures, laws, and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan  
Comptroller of the Treasury

JGM/cj  
01/060



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COMPTROLLER OF THE TREASURY  
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March 29, 2001

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Economic and Community Development for the years ended June 30, 2000, and June 30, 1999.

We conducted our audit in accordance with government auditing standards generally accepted in the United States of America. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Economic and Community Development's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Department of Economic and Community Development is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed one finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit finding; we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding.

We have reported other less significant matters involving the department's internal controls and instances of noncompliance to the Department of Economic and Community Development's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA  
Director

AAH/cj

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

**Department of Economic and Community Development**

For the Years Ended June 30, 2000, and June 30, 1999

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## AUDIT SCOPE

We have audited the Department of Economic and Community Development for the period July 1, 1998, through June 30, 2000. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the Community Development Block Grant Program; small business energy loans; deferred revenue; compliance with the Financial Integrity Act; and utilization of the Department of Finance and Administration's State of Tennessee Accounting and Reporting System (STARS) grant module to record the receipt and expenditure of federal funds. The audit was conducted in accordance with government auditing standards generally accepted in the United States of America.

## AUDIT FINDING

### **Internal Controls Over Federal Reporting Need Improvement**

The department does not follow its procedures implemented to ensure the accuracy of federal reporting. The Performance and Evaluation Report is submitted to the federal authority on an annual basis. Tests of the reports submitted during the period under audit revealed several discrepancies. These reports were not reviewed by management prior to submittal to the federal authority (page 8).

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"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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**Audit Report**  
**Department of Economic and Community Development**  
**For the Years Ended June 30, 2000, and June 30, 1999**

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# **Department of Economic and Community Development For the Years Ended June 30, 2000, and June 30, 1999**

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## **INTRODUCTION**

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### **POST-AUDIT AUTHORITY**

This is the report on the financial and compliance audit of the Department of Economic and Community Development. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

### **BACKGROUND**

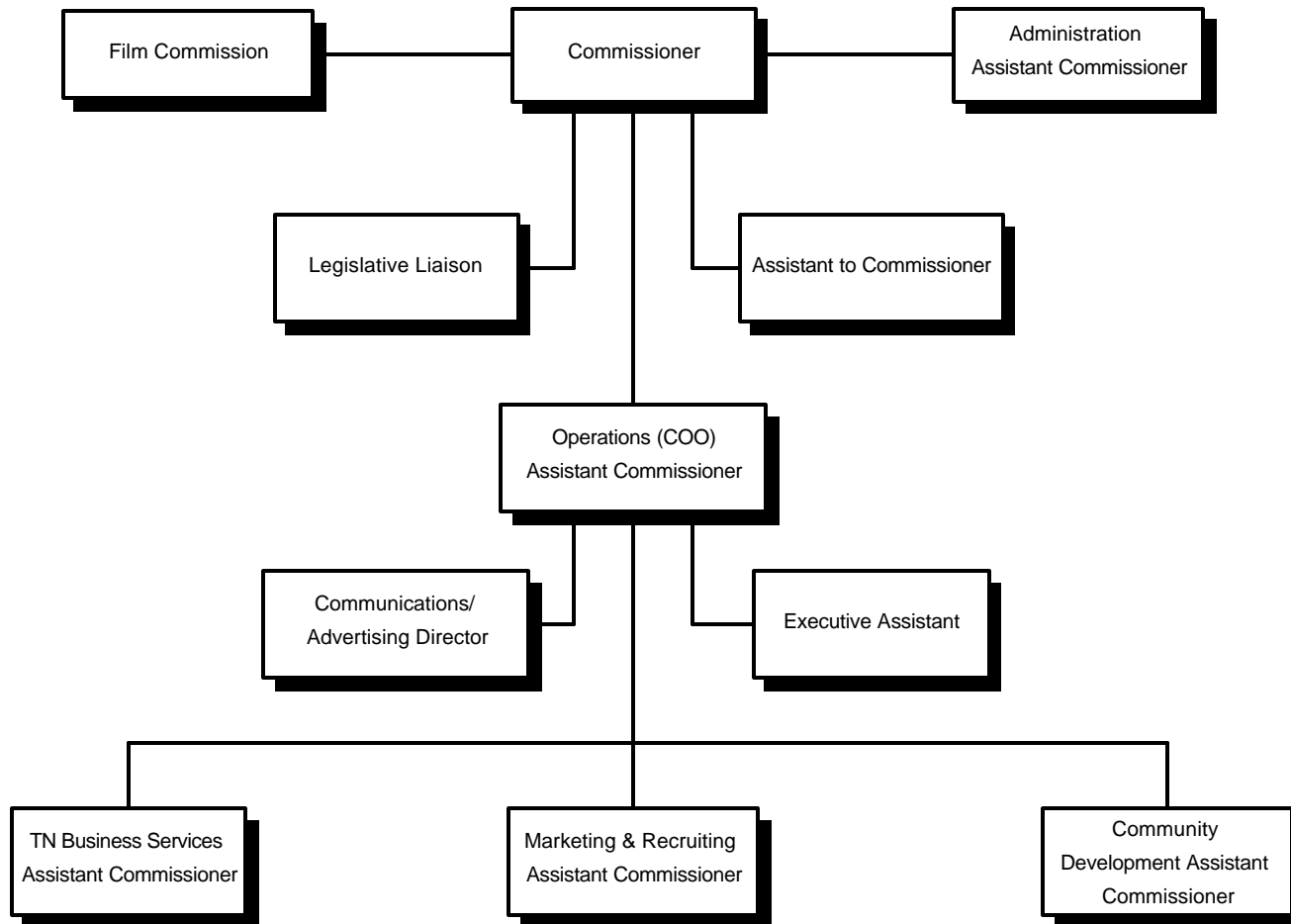
The mission of the Department of Economic and Community Development is to increase job opportunities throughout Tennessee. The department’s goals are to enhance community attractiveness and readiness for creating job opportunities; to create and promote business ventures to entrepreneurs, existing industries, and new firms; and to increase and improve those economic growth possibilities for all new and existing firms.

The department’s mission is to assist local communities in capitalizing on economic development opportunities, marketing that state, recruiting environmentally responsible new industries, assisting existing firms, and increasing export trade opportunities for Tennessee business and industry.

The department’s vision is to build the nation’s most business-friendly state with the best, most professional people, providing services that exceed consumer expectations on a daily basis.

An organization chart of the department is on the following page.

## Department of Economic and Community Development



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## **AUDIT SCOPE**

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We have audited the Department of Economic and Community Development for the period July 1, 1998, through June 30, 2000. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the Community Development Block Grant Program; small business energy loans; deferred revenue; compliance with the Financial Integrity Act; and utilization of the Department of Finance and Administration's State of Tennessee Accounting and Reporting System (STARS) grant module to record the receipt and expenditure of federal funds. The audit was conducted in accordance with government auditing standards generally accepted in the United States of America.

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## **PRIOR AUDIT FINDINGS**

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There were no findings in the prior audit report.

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## **OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS**

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### **COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM**

The Community Development Block Grant (CDBG) program is authorized under Title I of the Housing and Community Development Act of 1974, as amended by Title 42 of the United States Code, Section 5301. One of the primary objectives of the program is the development of viable communities by providing decent housing, a suitable living environment, and expanded economic opportunities, principally for persons of low and moderate income.

Our audit of the CDBG program focused primarily on the following areas:

- General Internal Control
- Activities Allowed and Allowable Costs
- Cash Management
- Davis-Bacon Act
- Earmarking

- Program Income
- Reporting
- Subrecipient Monitoring
- Special Tests and Provisions
- Schedule of Expenditures of Federal Awards

The primary audit objectives, methodologies, and our conclusions for each area are stated below. For each area, auditors documented, tested, and assessed management's controls to ensure compliance with applicable laws, regulations, grants, contracts, and state accounting and reporting requirements. To determine the existence and effectiveness of management's controls, auditors administered planning and internal control questionnaires; reviewed policies, procedures, and grant requirements; prepared administrative control memos; performed tests of controls; and assessed risk.

### **General Internal Control**

Our primary objectives were to document departmental procedures and assess management's general controls. We interviewed key program employees and reviewed organization charts, written procedures, job responsibilities within each division, and correspondence from the grantor. The overall control environment of the CDBG program was considered, in conjunction with the assessments of controls.

We did not note any significant deficiencies in management's general internal controls related to the CDBG program.

### **Activities Allowed or Unallowed and Allowable Costs / Cost Principles**

The primary objectives of this area were to determine if

- grant funds were expended only for allowable activities,
- federal expenditures were in compliance with grant requirements, and
- direct charges to federal awards were for allowable purposes.

We tested nonstatistical samples of expenditure transactions to determine if program costs were adequately supported, charged to the applicable grant program and cost category, properly approved, and paid correctly. Supporting documentation for block grant expenditures was examined to determine if the charges were valid and allowable. Based on our testwork, the department had expended grant funds for allowable activities, expenditures were in compliance with grant requirements, and direct charges to federal awards were for allowable purposes.

## **Cash Management**

The primary objectives of this area were to determine

- management's compliance with the applicable terms and conditions of the agreement between the state and the Secretary of the Treasury, United States Department of the Treasury (Treasury-State Agreement);
- if federal funds were requested in accordance with the appropriate cut-off; and
- if funds were received and credited to the state account within the time prescribed in the Treasury-State Agreement funding technique.

We tested federal cash drawdown transactions in the audit period for compliance with the Treasury-State Agreement. Supporting documentation for each drawdown transaction was obtained and examined.

Based on the testwork performed, we determined that management had complied, in all material respects, with the Treasury-State cash management agreement and that funds were received and credited to the state account within the time prescribed in the Treasury-State Agreement funding technique.

## **Davis-Bacon Act**

The primary objective of this area was to determine if the department ensured that contractors and subcontractors paid prevailing wage rates on applicable CDBG projects.

We reviewed contractor files for CDBG construction projects active during the audit period to determine whether the department monitored job classifications and wage rates. Contractor certifications were examined for propriety. Based on our review, it appears that the department monitored job classifications and that contractors and subcontractors paid prevailing wage rates on applicable CDBG projects.

## **Earmarking**

The primary objective for this area was to determine whether minimum or maximum limits of earmarking for specified purposes were met.

We reviewed the *Office of Management & Budget Circular A-133 Compliance Supplement* to identify the applicable percentage and dollar requirements for earmarking. To determine if the minimum amount of funds were used in the manner specified by the federal grantor, we traced total program expenditures for the audit period to the accounting records. Total expenditures

reported were compared to the grant allocations to determine if the required percentages were met. Based on our testwork, the department met the earmarking requirements for the CDBG program.

## **Program Income**

Our main objective in this area was to determine if program income was correctly recorded and used in accordance with program requirements.

We reviewed the regulations and provisions of the grant agreement applicable to the CDBG program to identify the requirements for recording and using program income. We tested a nonstatistical sample of deposits during the audit period for propriety. Supporting documentation for each deposit transaction was obtained and examined.

Based on the testwork performed, we determined that program income was correctly recorded in the accounting records.

## **Reporting**

Our primary objectives in this area were to determine if

- the information submitted to the federal awarding agency included all activity of the reporting period;
- federal reports were supported by underlying accounting or performance records; and
- federal reports were submitted in accordance with program requirements.

We inquired of management about the requirements and department's procedures for preparing, reviewing, and submitting program reports. We tested the mathematical accuracy of certain information in selected reports, reviewed supporting documentation for the information presented, and determined if the selected reports were prepared in accordance with grant guidelines.

Our review of federal financial and program activity reports revealed that management did not consistently follow the department's procedures for reviewing reports prior to submission. As a result, several reporting errors were noted. (See finding for more information.)

## **Subrecipient Monitoring**

Our primary objectives for this area were to determine if the department

- properly monitored subrecipients (small cities) to ensure compliance with federal award requirements;
- required appropriate corrective action on monitoring and audit findings; and
- provided adequate federal award and compliance requirement information to subrecipients.

We reviewed management's procedures for informing subrecipients of award information and compliance requirements, and for monitoring subrecipients. We tested a nonstatistical sample of the monitoring reports for the audit period to determine that field visits were documented, deficiencies were documented and reported to the subrecipient, and that the subrecipient initiated corrective action procedures. We also reviewed the correspondence between the department and the subrecipient to verify compliance with resolution procedures.

Based on our testwork, the department properly monitored its CDBG program subrecipients and required appropriate corrective action on findings. Furthermore, it appears that the department provides adequate federal award and compliance information to its subrecipients.

## **Special Tests and Provisions**

### **Environmental Oversight and Reviews**

The primary objectives for this area were to determine if the department

- carried out its environmental oversight responsibilities and functions, and
- conducted the required environmental reviews.

We reviewed the rules and regulations for this compliance requirement and tested a nonstatistical sample of expenditures to determine if funds were expended or obligated before the department approved its Request for Release of Funds (RROF). Project files were reviewed to verify that the department obtained environmental review certifications from the subrecipient where applicable. We verified that written determinations were filed on projects where an environmental review was not performed.

Based on our review, we determined that, in all material respects, the department had carried out its environmental oversight and review responsibilities and that any determinations not to make an environmental review were consistently made based on regulation criteria.

### **Schedule of Expenditures of Federal Awards**

Our objective was to verify that the Schedule of Expenditures of Federal Awards was properly prepared and adequately supported. We verified the grant identification information on the Schedule of Expenditures of Federal Awards prepared by the department, and total reported disbursement amounts

were traced to the accounting records and supporting documentation. Based on the testwork performed, we determined that the Schedule of Expenditures of Federal Awards was properly prepared and adequately supported in all material respects.

### **Finding, Recommendation, and Management's Comment**

#### **Internal controls over federal reporting need improvement**

##### **Finding**

The Department of Economic and Community Development does not follow its procedures designed to ensure the accuracy of federal reporting. The Performance and Evaluation Report submitted to the Tennessee Housing Development Authority (THDA) is due within 90 days after the close of the applicable program year. This report includes a description of the use of funds during the applicable program year and an assessment of the department's use of funds compared to its planned priorities and objectives.

According to written departmental procedures, the Accounting Manager must review the report before it is submitted to the Tennessee Housing Development Authority. However, it was determined that the Accounting Manager did not adequately review the reports during the audit period. The review of the information submitted on the performance and evaluation reports revealed several discrepancies:

- program income on the 1998 Performance and Evaluation Report was understated by \$32,246.00,
- transposition errors were found for amounts obligated to recipients on the 1998 report,
- amounts charged to administration on the 1999 Performance and Evaluation Report did not agree to the line item budget amounts in the department's financial files,
- grantee total budgets on the 1999 report did not agree with the total budget in the department's financial files, and
- data relating to the low-to-moderate-income objective were also incorrectly reported due to keying errors.

Management stated that the deficiencies were the result of keying errors; however, it appears that the discrepancies could have been detected during the report review process. Furthermore, these reports contain cumulative data. Management stated that it combines the data from the preceding report with the current period data to present the cumulative data. Therefore, errors on one report are likely to be repeated on subsequent reports.

## **Recommendation**

The Community Development Block Grant Program Director and Accounting Manager should comply with its control procedures and ensure that the performance evaluation report is reviewed for accuracy and completeness before it is submitted to the Tennessee Housing Development Authority.

## **Management's Comment**

We concur. The department agrees to do a better job in internal controls over federal reporting.

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### **SMALL BUSINESS ENERGY LOANS**

Our main objective for this area was to determine if the department properly protected its security interest in collateral for these small business loans through the timely filing of Uniform Commercial Code (UCC) filing statements.

We reviewed the department's written procedures to gain an understanding of the program administered by the Division of Energy. We interviewed key personnel to document the administrative controls over the small business energy loans program. We tested the loans issued during the audit period by comparing the loan date to the date that the UCC statements were filed with the Secretary of State and the county Register of Deeds. We determined that loans were issued in compliance with applicable rules and regulations of the program.

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### **DEFERRED REVENUE**

The primary objectives for this area were to

- determine if earned revenue was transferred from deferred revenue in a timely manner;
- determine if deferred revenue transactions were adequately supported; and
- reconcile the department's deferred revenue account balance with the State of Tennessee Accounting and Reporting System (STARS) account balance at year-end.

We interviewed key personnel to gain an understanding of the department's controls over accounting and transferring deferred revenue. We tested nonstatistical samples of deferred revenue transactions for propriety. Supporting documentation for each selected transaction was obtained and examined to determine if the department made transfers from the account in a timely manner. We documented the purpose of each deferred revenue account and scheduled the activity by month. Additions and deletions were traced to supporting documentation and the accounting records.

Based on the results of our testwork, it appears that deferred revenue transactions were adequately supported. Although accounting entries transferring deferred revenue to earned revenue were not always made timely, we determined that the necessary entries were made in the fiscal year, and the department's account balance reconciled with the STARS balance at year-end.

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## FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30, 1999, and each year thereafter. In addition, the head of each executive agency is also required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objectives were to determine whether

- the department's June 30, 2000, and June 30, 1999, responsibility letters and December 31, 1999, internal accounting and administrative control report were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*;
- documentation to support the department's evaluation of its internal accounting and administrative control was properly maintained;
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*; and
- corrective actions have been implemented for weaknesses identified in the report.

We interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the department's procedures. We also reviewed the supporting documentation for these procedures. We reviewed the June 30, 2000, and June 30, 1999, responsibility letters and the December 31, 1999, internal accounting and administrative control report submitted to the Comptroller of the Treasury and to the Department of Finance and Administration to determine adherence to submission deadlines. To determine if corrective action plans had been implemented, we interviewed management and reviewed supporting documentation as considered necessary.

We determined that the Financial Integrity Act responsibility letters and internal accounting and administrative control report were submitted on time, support for the internal accounting and administrative control report was properly maintained, and procedures used were in compliance with *Tennessee Code Annotated*.

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## **DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, “RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES”**

Department of Finance and Administration Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS grant module to record the receipt and expenditure of all federal funds. Our objectives were to determine whether

- appropriate grant information was entered into the STARS Grant Control Table upon notification of the grant award, and related revenue and expenditure transactions were coded with the proper grant codes;
- the department made drawdowns at least weekly using the applicable STARS reports; and
- the department utilized the appropriate STARS reports as bases for preparing the Schedules of Expenditures of Federal Awards and reports submitted to the federal government.

We interviewed key personnel to gain an understanding of the department’s procedures and controls concerning Policy 20. Based on our interviews, reviews, and test work, the department was in compliance with F&A Policy 20. The department had fully utilized the STARS Grant Module to record the receipt and expenditure of all federal funds and made drawdowns in a timely manner. The department also used the appropriate STARS reports as the basis for preparing the Schedule of Expenditures of Federal Awards and reports submitted to the federal government.

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## **OBSERVATIONS AND COMMENTS**

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### **TITLE VI OF THE CIVIL RIGHTS ACT OF 1964**

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30, 1994, and each June 30 thereafter. The Department of Economic and Community Development filed its compliance reports and implementation plans on June 30, 2000, and June 30, 1999.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds.

On October 15, 1998, the commissioner of Finance and Administration notified all cabinet officers and agency heads that the Human Rights Commission is the coordinating state agency for the monitoring and enforcement of Title VI.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

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## APPENDIX

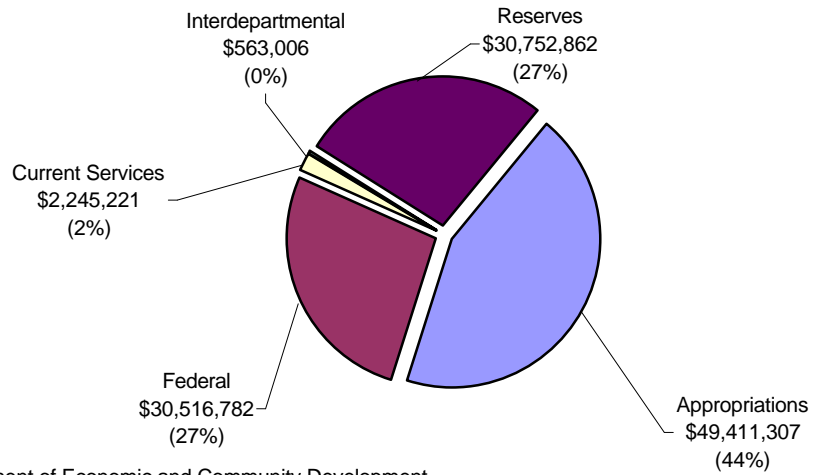
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Department of Economic and Community Development divisions and allotment codes:

330.01	Administrative Services
330.02	Industrial Development
330.03	Small & Minority-Owned Telecommunications Program
330.04	Regional Grants Management
330.05	Business Services
330.06	TIIP – 95 County Jobs Program
330.07	Community Development
330.08	Energy
330.09	Industrial Training Service
330.10	Small Business Energy Loan Program
330.11	Local Government Energy Loan Program
330.13	Skills Fund

## Revenue by Source

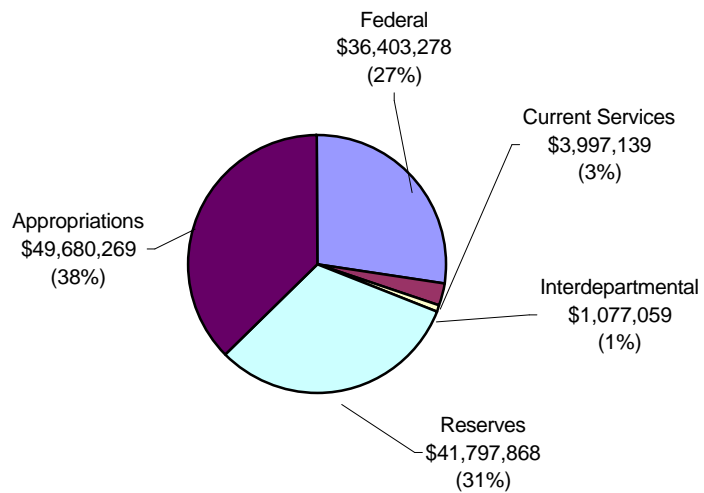
Fiscal Year Ended June 30, 1999 (Unaudited)



Source: Department of Economic and Community Development

## Revenue by Source

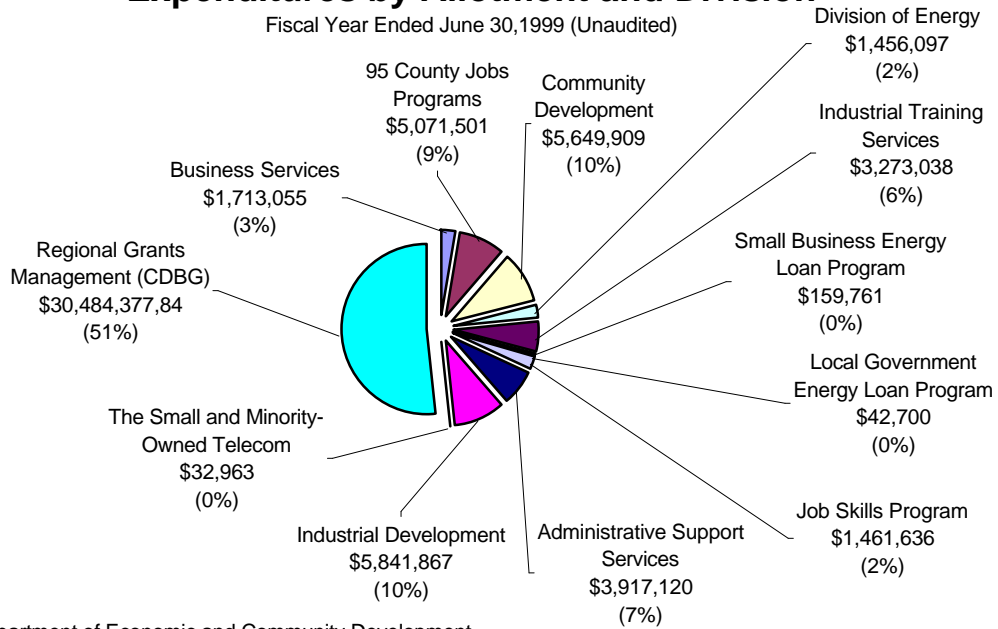
Fiscal Year Ended June 30, 2000 (Unaudited)



Source: Department of Economic and Community Development

## Expenditures by Allotment and Division

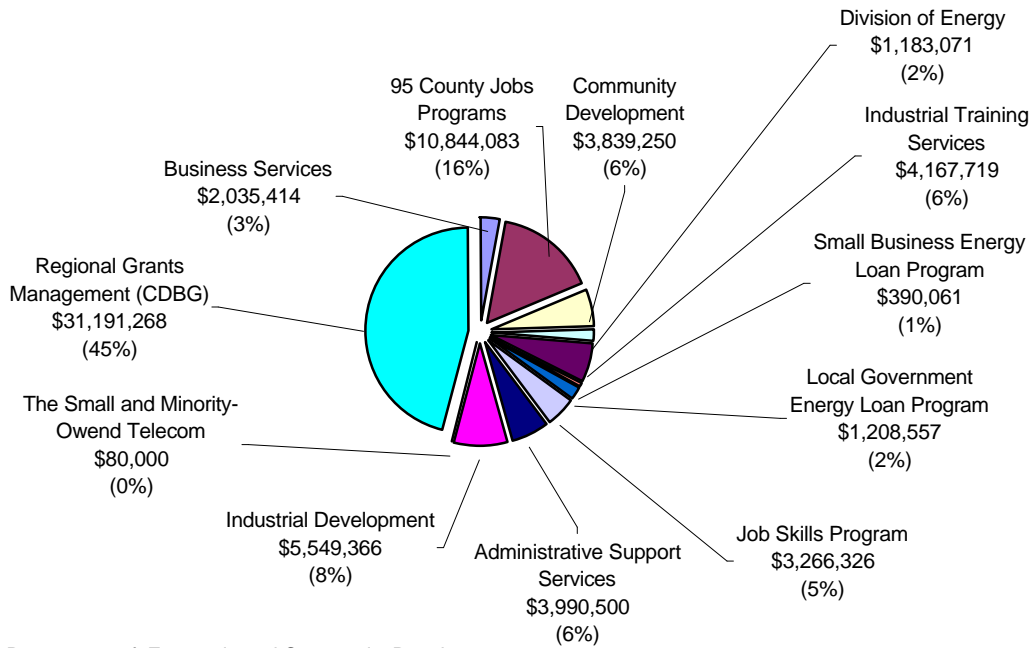
Fiscal Year Ended June 30, 1999 (Unaudited)



Source: Department of Economic and Community Development

## Expenditures by Allotment and Division

Fiscal Year Ended June 30, 2000 (Unaudited)



Source: Department of Economic and Community Development